STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION

WISCONSIN ENERGY CORPORATION, INTEGRYS ENERGY GROUP, INC., PEOPLES ENERGY, LLC, THE PEOPLES GAS LIGHT AND COKE COMPANY, NORTH SHORE GAS COMPANY, ATC MANAGEMENT INC., and AMERICAN TRANSMISSION COMPANY LLC	)	
Application pursuant to Section 7-204 of the Public Utilities Act for authority to engage in a Reorganization, to enter into agreements with affiliated interests pursuant to Section 7-101, and for such other approvals as may be required under the Public Utilities Act to effectuate the Reorganization.	)	**DOCKET No. 14-0496**

DRAFT ORDER
OF
THE CITY OF CHICAGO AND THE CITIZENS UTILITY BOARD

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The City of Chicago ("City") and the Citizens Utility Board ("CUB") (together "City/CUB"), pursuant to Section 200.810 of the Rules of Practice of the Illinois Commerce Commission ("ICC" or "Commission"), 82 Ill. Adm. Code 200.810, and the briefing schedule established by the Administrative Law Judge ("ALJ") in this case, submit their Draft Order in this proceeding.

ORDER

I. INTRODUCTION/PROCEDURAL HISTORY

II. APPLICABLE LEGAL STANDARDS

A principal contested issue in this proceeding are the legal standards for determining whether approval of the proposed reorganization is authorized and what (if any) conditions or commitments are necessary to make the reorganization appropriate under the applicable statute. This proceeding was initiated by an application filed under PUA Section 7-204. Its application as governing law is not contested by any party. Because the Commission's conclusion on the meaning of that statute could be determinative in this case, the Commission will address that issue separately, and apply the standards it in the more focused discussions that follow.

Burden of Proof

One aspect of the law governing this proceeding is undisputed by the parties. The Joint Applicants, as applicants, have the burden of proving that the proposed reorganization meets the requirements of Section 7-204. The Commission is required to base its decisions on the entire record. Consequently, in the presence of opposing evidence, the Joint Applicants must present more than just a *prima facie* case; the record as a whole must support findings that the statutory requirements are met. As the Commission has held:

> [T]he structure of subsection 7-204(b) puts the burden of satisfying its sub-parts on the reorganization petitioner. That is, the text of that section precludes merger approval unless the specified findings can be made. Thus, the adverse consequence of presenting insufficient evidence for the Commission to make the requisite findings fall upon the JA here.

AGL Resources Inc., Nicor Inc. and Northern Illinois Gas Company d/b/a Nicor Gas Company, Application for Approval of a Reorganization Pursuant to Section 7-204 of the Illinois Public Utilities Act, ICC Docket No. 11-0046, Final Order of December 7, 2011 at 45 ("*Nicor Merger*"). Parties questioning the reorganization are not required to show that the harms described in Section 7-204(b)'s criteria will result from the proposed reorganization. Rather, the Joint Applicants' evidence must support the required Section 7-204(b) findings, at the statutory level of certainty

In the *Nicor Merger* proceeding, the Commission reminded parties that conclusory assertions that statutory requirements have been met do not guarantee approval. Such statements are expected, if not required, but in the presence of opposing evidence likely insufficient unless supported by other record evidence. The Commission distinguished "declarations of good intentions" from "meaningful evidence about . . . critical operational details post-reorganization."

Section 7-204(b) and Section 7-204(f)

The Joint Applicants argue that an applicant need only address the listed requirements of subsection (b) of Section 7-204 to gain approval. JA Init. Br. at 5. In support of their position, the Joint Applicants rely on a 1999 Commission decision, *In re SBC Communications, Inc., et al.*, ICC Docket No. 98-0555, 1999 Ill. PUC LEXIS 738 (Sept. 23, 1999) at *26 ("*SBC Communications*"). The Joint Applicants draw from that decision a conclusion that

subsection (f) of Section 7-204 has no independent significance, and that meeting the mandatory requirements of subsection (b) has the substantive effect of protecting utility and ratepayer interests as subsection (f) requires.

City-CUB state that the Joint Applicants selectively acknowledge and apply the provisions of Section 7-204. In particular, City-CUB argue that the Joint Applicants do not acknowledge or properly apply the substantive requirements of Section 7-204(f). As a result, City-CUB argue, the Joint Applicants applied incorrect legal standards, making their evidentiary and legal conclusions flawed.

Since the Joint Applicants' statutory interpretation would completely nullify the legislature's explicit grant of authority to impose conditions necessary to protect the interests of Illinois utilities and ratepayers under Section 7-204(f), City-CUB argue that the Joint Applicants' interpretation unlawful' They assert that under binding Illinois Supreme Court precedent, every provision of Section 7-204 must be given substantive meaning. *Kraft, Inc. v. Edgar*, 138 Ill 2d 178 (1990) at 189 ("A statute should be construed so that no word or phrase is rendered superfluous or meaningless.").

In response to the Joint Applicants' reliance on *SBC Communications*, City-CUB argue that even if, at one time, the Commission accepted the Joint Applicants' position, the Commission has since recognized its error and abandoned that Applicants' interpretation. City-CUB cite the more recent *Nicor Merger* proceeding, in which the Commission examined the statute's meaning and application in some detail. The Commission found that the public interest provisions of Section 7-102 and Section 7-204 provide independent authority that does not depend on, and is not subsumed by, Section 7-204(b)'s list of threshold criteria. *Nicor Merger* at 43-45, 56. The Commission further stated that "Subsection 7-204(f) does not exempt any component of utility operations from its purview." Using its broader Section -204(f) authority in that case, the Commission ordered corrective conditions independent of the requirements of 204(b).

The Commission affirms its more recent interpretation of Section 7-204. That statutory construction, recognizing that Section 7-204(f) has substantive, is more consistent with governing case law, and is more consistent with the legislative policy of comprehensive regulation of Illinois utility corporate reorganizations.

Effect of Commitments and Conditions

City-CUB also argue that if commitments are made by the Joint Applicants or conditions are imposed by the Commission, to help meet statutory requirements for reorganization approval, those commitments or conditions must meet additional standards. City-CUB maintain that they must be permit effective Commission oversight and compliance enforcement; and define consequences that effectively deter non-compliance. *See* City/CUB Ex. 4.0 at 23:555. They argue further that since the required Commission findings must be made in this proceeding -- not at some later date -- the commitment or conditions must be (a) defined and in-place, (b) effective in preventing adverse impacts, and (c) immediately operative. They concluded if the Commission cannot make the required findings now, the mandated level of protection for Illinois utility and customer interests is not achieved. City-CUB emphasize the timing of the required Commission findings; the Commission must find that the statutory requirements are met now. If terms or conditions that involve future action (whether proposed or imposed) are part of the basis for approval, the Commission must find that the future action is sufficiently clear, certain, and

timely that the Commission can make a sustainable finding that statutory requirements (at the specified level of proof) have been satisfied. No other party addressed these elements of City-CUB's arguments on what must be demonstrated.

The Commission appreciates the validity of City-CUB's cautions about the timeliness, effectiveness, and enforceability of offered commitments or imposed conditions. The Commission has assessed and rule on the record evidence concerning statutory requirements with objectives in mind.

Finally, the Commission reminds all parties that it takes very seriously its obligation to gather and consider a full record, and to render its decisions based on the entire record. The integrity of the Commission proceedings and decisions require that parties also address the entire record in their post-hearing briefs -- both initial and reply. Argument in briefs that tactically ignore portions of the record deny the Commission parties' analyses of the entire record, and may give unfair advantage to a party be denying other parties an opportunity to respond to arguments held back. Our Rules of Practice require that we act to negate any prejudice suffered unfairly by parties. We are bound by our rules and will apply them where appropriate. *See In re Central Illinois Light Co. d/b/a AmerenCILCO, et al.*, ICC Docket No. 06-0070/06-0071/06-0072 (Cons.), Order on Rehearing at 35 (May 16, 2007) (earlier admonishment on same point).

III. THE STATUTORY REQUIREMENTS

A. Section 7-204(b)(1) -- ability to meet PUA service obligations not diminished

City/CUB Position

City/CUB argued that if the Commission approves the proposed reorganization, PGL's AMRP must not be managed and operated as a consequence-free funding stream. City/CUB noted that the PUA's reorganization provisions expressly grant the Commission clear authority and broad discretion to "impose such terms, conditions or requirements as, in its judgment, are necessary to protect the interests of the public utility and its customers," in approving any proposed reorganization. 220 ILCS 5/7-204(f). In addition, City/CUB noted that the PUA prohibits the Commission from approving any reorganization that if finds "will adversely affect the utility's ability to perform its duties under this Act." 220 ILCS 5/7-204(b). The Commission is also prohibited, City/CUB observed, from approving a reorganization unless it finds that "the proposed reorganization will not diminish the utility's ability to provide adequate, reliable, efficient, safe and least-cost public utility service." *Id.*

City/CUB also noted that the Joint Applicants concede that the ability of the new owner to manage AMRP properly is relevant to this proceeding, and that, if left uncorrected; the acknowledged AMRP mismanagement can worsen performance (an expectation that does not satisfy the threshold statutory requirements for approval). Tr. 328:10-14, 329 (Hesselbach). City/CUB's testimony presented by Mr. William Cheaks Junior illustrated the negative public safety, reliability, quality-of-life, and infrastructure coordination impacts that a poorly managed AMRP can impose on Chicago's ratepayers.

City/CUB argued that this proceeding is an appropriate, and in fact the only, proceeding in which the Commission can impose conditions on the continued operation of AMRP in the context of the proposed reorganization, to protect the interests of PGL's ratepayers.

City/CUB observed that the proposed reorganization will change the management and operation of AMRP. Tr. 137 (Schott, re budgets and funding); *also* Tr. At 151-152, 20-22 (Leverett, significant decisions would receive input from the holding company). City/CUB also noted that the Joint Applicants have stated their intention to change (1) the management responsible for AMRP at PGL itself, and (2) the parent company's management responsible for AMRP. JA March 18, 2015 Response to Commissioners' Data Request at 3.

City/CUB noted the myriad ways in which the proposed reorganization will change the management and operation of AMRP – from a change in lobbyists who influence legislation affecting AMRP, to a change in design and engineering personnel who work directly on AMRP, to a change in who decides the budgetary and financial aspects of AMRP, and to new policies and procedures applicable to AMRP construction activities. Absent concrete commitments from the Joint Applicants, City/CUB noted, knowledgeable employees who work on AMRP now may not be the same employees who work on AMRP in the future.

Regarding Wisconsin Energy's experience as a replacement for Integrys', Mr. Cheaks testified that it does not "give [him] confidence that PGL's AMRP will be managed any better than it already is." City/CUB Ex. 3.0 at 914-915. City/CUB noted that neither WEC nor any other Joint Applicant requested PGL to provide a detailed work plan of the AMRP as part of its due diligence review. CUB Ex. 3.1 (JA-AG 4.01). City/CUB noted that WEC has no transition plan for AMRP and "no specific plans at the present time with respect to the use of WEC Energy Group's cash flows for the funding of Peoples Gas' AMRP." CUB Ex. 3.1 (JA-City 2.22).

As Mr. Cheaks noted, "[u]nsafe or inefficient implementation could actually harm Illinois ratepayers' interests, if the Commission does not act to compel correction of AMRP deficiencies and to disallow imprudent expenditures." City/CUB Ex. 7.0 at 193-195. As Mr. Cheaks concluded, "[t]he Audit Report provides strong, unsolicited, and independent support for imposing conditions regarding AMRP performance as a condition of any approved reorganization." City/CUB Ex. 9.0 at 22-24. If the Commission fails to act on the Audit Report in this proceeding, City/CUB noted that it may have to wait until 2020 for the next PGL or NS rate case before it has the opportunity to act on the cost and service implications of PGL's response to that report. City/CUB Ex. 9.0 at 24-27. City/CUB also pointed out that Wisconsin Energy's witnesses have already admitted their disagreement with some of the findings of the Interim Audit Report. Tr. 91 (Schott).

City/CUB pointed out that the record is replete with instances of poor AMRP management leading to construction problems. City/CUB noted that while WEC admits that "developing an integrated scheduling approach" appears reasonable and is likely to lead to an increase in efficiency for both AMRP and non-AMRP work, the Joint Applicants have failed to commit to develop such an approach. JA Ex. 13.0 at 132-134. In order to ensure that PGL will be able to provide reliable, adequate, and least-cost service, City/CUB concluded that the Commission should require PGL to participate in the dotMaps website and provide weekly block-by-block schedules.

Commission Analysis and Conclusion

The Commission finds that, without conditions requiring the provision of weekly block-by-block schedules and participation in the dotMaps website, the Commission cannot conclude that approval of the proposed reorganization would not diminish the utility's ability to provide adequate, reliable, efficient, safe and least-cost public utility service. The record evidence

demonstrates that what was once improper management has been made worse by the proposed reorganization, and the new owners have no definite plans to eliminate the deficiencies that have started to be corrected and those which might be identified in the future. Lacking relevant experience and with no commitment to deploy corporate funds, Wisconsin Energy's purported track record cannot fill the gap left in this record by the Joint Applicants. The Commission thus holds that any approved reorganization must contain commitments to: (1) provide weekly block-by-block schedules to CDOT and (2) participate in the dotMaps website.

B. Section 7-204(b)(2) -- no subsidization of non-utility activities

City-CUB Position

City-CUB argue that the deficiencies in the readiness and effectiveness of the Joint Applicants' accounting and ratemaking protocols for transition costs, in particular those incurred at proposed affiliates but allocated to Illinois utilities for rate recovery creates uncertainties that preclude a finding that "the proposed reorganization will not result in unjustified subsidization of nonutility activities by the utility or its customers." The Commission will address this issue in its discussion of Section 7-204(b)(7) requirements.

C. Section 7-204(b)(3) -- fair allocation of costs for ratemaking

City-CUB POSITION

City-CUB argue that the deficiencies in the readiness and effectiveness of the Joint Applicants' accounting and ratemaking protocols for transition costs, in particular those allocated between utility and non-utility activities, for rate recovery creates uncertainties that preclude a finding that "the proposed reorganization will not result in unjustified subsidization of nonutility activities by the utility or its customers." The Commission will address this issue in its discussion of Section 7-204(b)(7) requirements.

D. Section 7-204(b)(4) -- no impairment of ability to raise capital

City-CUB Position

1. Impact of Reorganization Debt on Illinois Utilities

City-CUB point out that Section 7-204(b)(4) of the PUA prohibits the Commission from approving a reorganization if the Commission finds that it will (1) significantly impair the utility's ability to raise necessary capital on reasonable terms or (2) fail to maintain a reasonable capital structure. City-CUB note that the financing structure of the Joint Applicants' proposed reorganization will result in a significant increase to the amount of debt at the parent company (to be known as "WEC Energy Group"). City-CUB Ex. 4.0 at 12:287-292. It is uncontested that the financing plan accommodates the premium above prevailing book value that WEC agreed to pay to acquire Integrys' common stock. *Id*. at 13:305-308. WEC Energy Group will take on $1.5 billion of acquisition debt to fund the purchase. City-CUB note that the cash to service that debt will come from its utility subsidiaries, including Peoples Gas and North Shore Gas. *Id*. at 13:309-314. City-CUB aver that the analysis of whether ratepayers are at risk of adverse rate impacts includes consideration of the utility's access to capital and its other obligations due to existing and future debt. *Ill. Consolidated Telephone Co.,* ICC Docket. No. 02-0502, Final Order of December 17, 2002 at 25-26.

City-CUB state that Peoples Gas and North Shore Gas currently access capital markets on reasonable terms. Staff Ex. 7.0 at 4:70-81. Prior to the announcement of the proposed reorganization, City-CUB note that Standard & Poor's ("S&P") had assigned the Companies an A- issuer rating (strong capacity to meet financial commitments, but somewhat more susceptible to adverse circumstances than higher rated entities), and Moody's Investors Service ("Moody's") had assigned the Companies an A1 issuer rating (upper-medium grade and subject to low credit risk). *Id.* However, state City-CUB, following the announcement of the proposed reorganization in June 2014, S&P revised its forward-looking credit outlook for the Companies from "stable" to "negative." S&P cited expectations that "the incremental debt associated with this transaction will weaken WEC's financial measures," and indicated that the credit ratings of the Companies will be aligned with that of their new parent (WEC Energy Group). CUB Cross Ex. 3, JA MGM 1.15 Attach 02 at 3; 5-6; *see also* Staff Ex. 7.0 at 5:88-110. Further, note City-CUB, S&P elaborated that the consolidated company could fall into the "weaker end of our 'significant' financial risk profile…leaving little cushion for underperformance relative to our forecast." *Id.*

City-CUB point out that Fitch Ratings ("Fitch") had a similar response. Fitch placed WEC on "Rating Watch Negative" the day following the proposed reorganization announcement, going to far as to say that "[g]iven WEC's projected incremental leverage and pending acquisition of Integrys, a positive rating action is unlikely in the near to immediate term." CUB Cross Ex. 3, JA MGM 1.15 Attach 03 at 1-2. Fitch further noted that regulatory actions like rate freezes as a reorganization approval condition could lead to negative rating actions. *Id.* at 2. City-CUB elaborate that Fitch stated that the merger would result in a "meaningful increase in consolidated leverage compared to WEC's current and projected pre-acquisition financial position," and noted its additional concern about the "aggressive dividend policy adopted by management." *Id.* Fitch added that it "expects leverage metrics of the combined entities to be weak for the current rating category and significantly weaker than WEC's stand-alone credit profile." *Id.* at 2.

Similarly, note City-CUB, Moody's changed its rating outlook for WEC from stable to negative following the proposed reorganization announcement, though they have not yet revised their outlooks for the NS-PGL. CUB Cross Ex. 3, JA MGM 1.15 Attach 01 at 1.

City-CUB state that the most recent financial press available prior to the evidentiary hearing in this case, UBS Reports -- an equity analyst on which Joint Applicant witness Mr. Reed relies (Tr. 419:8-22, 430:17-22) -- considered the investment risks of WEC. In that report, dated February 12, 2015, UBS stated, with regard to the industry in general, "We expect cost-cutting and strategic planning to be a theme across both regulated and competitive companies… *We believe utilities with high parent leverage will disproportionately suffer, as they are unable to recoup from rising interest rates*." CUB Cross Ex. 2 at 2 (emphasis added). City-CUB aver this analyst expectation directly applies to the proposed reorganization, as WEC intends to fund the reorganization transaction by significantly increasing its debt obligations at the corporate level and its only source of cash to service the acquisition debt will come from its utility subsidiaries (including Peoples and North Shore). City/CUB Ex. 4.0 at 12:290-292, 13:313-314. Mr. Reed agreed that interest rates are indeed expected to rise in coming years. Tr. 418:19-22. Thus, state City-CUB, the warning from the UBS report applies here – where there is high parent leverage and rising interest rates. At worst, then, the Companies' ability to access capital on

reasonable terms is likely to be negatively impacted. At best, say City-CUB, cost-cutting measures that are harmful to the Companies' ratepayers appear inevitable.

City-CUB point out that, while the testimony of the Joint Applicants' own witness, Mr. Scott Lauber, acknowledged that the credit rating agencies downgraded their outlooks for WEC following the proposed reorganization announcement, (JA Ex. 5.0 at 9:178-183), the Joint Applicants' Initial Brief cites only one part of the sentence in which that information appears. Their Initial Brief emphasizes only that the companies' *current*, pre-reorganization credit ratings were affirmed. *See* JA Init. Br. at 24 ("After the announcement of the proposed Reorganization, the Credit Rating Agencies reaffirmed their credit ratings for Wisconsin Energy, Integrys, and their operating utility subsidiaries, including the Gas Companies."). In his testimony, however, Mr. Lauber conceded that the *forward-looking credit outlooks* were, in fact, downgraded. JA Ex. 5.0 at 9:178-183.

Likewise, argue City-CUB, Joint Applicant witness Mr. Reed noted the ratings agencies outlook downgrades in his testimony. That information is also missing from the Joint Applicants' arguments in brief. *See* JA Ex. 3.0 at 24-26:477-524 ("Moody's did change its ratings 'outlook' from stable to negative for WEC . . . S&P concurrently reduced the outlook of WEC, Integrys and Integrys' subsidiary companies peoples Gas and North Shore Gas to 'negative' from 'stable' . . . Fitch had a similar reaction to the Transaction, placing WEC on 'Rating Watch Negative' due to concern about the need to issue $1.5 billion in new debt at the holding company level to finance the cash portion of the acquisition.")

City-CUB contend that the Joint Applicants overlook all of this inconvenient information in their Initial Brief, though it came from their own experts. City-CUB note that the Joint Applicants argue the direct opposite conclusion from what their own witnesses' testimony suggests – that NS and PGL may have enhanced access to capital following the Reorganization. JA Init. Br. at 24. In support of that proposition, the Joint Applicants again cite the testimonies of Mr. Lauber and Mr. Reed. *Id*. City-CUB's review of the cited testimony demonstrates, however, that the Joint Applicants' positive opinions (which are not consistent with those of unbiased market observers) are based on their own general assumptions that, as a larger company, WEC Energy Group *should eventually* have enhanced access to capital. JA Ex. 5.0 at 11:202-204, JA Ex. 3.0 at 28:571-581. But, say City-CUB, even Mr. Reed and Mr. Lauber cannot say that such hoped-for benefits will be seen in the near future ("There is no expectation that this will occur immediately.") JA Ex. 5.0 at 11:204-205. Rather than relying on the biased speculation from the Joint Applicants' witnesses about what *may* happen in the long-term future, City-CUB urge the Commission to rely on the impartial outlooks issued by the credit ratings agencies. Those agencies all forecast a diminished ability to obtain capital following the reorganization.

City-CUB point out that Staff witness Mr. McNally stated that it is, if not likely, "certainly possible" that the Companies' costs of capital will increase because of the proposed reorganization. Staff. Ex. 7.0 at 9:183-185; *compare* 220 ILCS 5/7-204(b)(4) (requiring a finding that "the proposed reorganization will not significantly impair the utility's ability to raise necessary capital on reasonable terms or to maintain a reasonable capital structure"). City-CUB contend that the lower credit ratings projected by S&P and Fitch will, all else equal, lead to higher debt costs for the Companies. *Id*. at 10:217-218. Higher debt costs would, in turn, lead to higher costs of both debt and equity. *Id*. at 10:218-219.

City-CUB argue that the Joint Applicants have not proposed any reorganization terms or conditions that would alter those cost of service (and rate) dynamics, or that would provide the statutory level of protection to Illinois utility ratepayers. *See* JA Ex. 15.1 Rev.; 220 ILCS 5/7-204(b)(4); *also compare* 220 ILCS 5/7-204(b)(7) (requiring a showing that adverse rate impacts are "not likely"). City-CUB aver that the Joint Applicants' proposed financial commitments (viz., Commitments 27-34) do not provide the certainty ("will not") or low risk ("not likely") that the statute requires. Some of the proposed commitments impose vague restrictions of uncertain meaning and effect. *See* Commitment 27 ("to the extent they existed prior to the entry of the final order"); Commitment 28 and 29 (prohibitions on loans and guarantees, but only to "non-utility affiliates"). The others serve mainly to require that the Joint Applicants file reports or studies with the Commission. *See* Commitment 30 and 31 ("shall file"), 32 ("shall present"), 33 ("should . . . be presented"), and 34 ("shall be filed"). City-CUB maintain that, since the Commission may be unwilling or unable to act in a timely manner to prevent the Section 7-204(b) harms noted, the required statutory findings depend on future independent actions of entities not involved in the reorganization, the threshold requirements for approval are not met.

City-CUB contend that there is real risk that the proposed WEC Energy Group will be forced to extract additional cash from its utility affiliates, above and beyond what has been proposed in this case, if cash flow is not realized as projected by the Joint Applicants. City-CUB Ex. 4.0 at 13:295-299; City/CUB Ex. 8.0 at 13:261, 270. Aside from the negative impacts on the Companies' costs of capital, such additional withdrawals could negatively impact the Companies' ability to fund important capital projects, including critical system modernization and improvement plans. *Id*. at 299-301. City-CUB argue that, given the credit rating agency outlooks and the Joint Applicants' failure to provide any evidence regarding the existence or significance of any negative effects, the Commission cannot find, at this time, that the reorganization will not significantly impair NS and PGL's ability to raise capital. City-CUB aver that the reorganization should be denied as failing to meet the statutory criteria of 7-204(b)(4).

Commission Analysis and Conclusions

Section 7-204(b)(4) of the PUA prohibits the Commission from approving a reorganization if the Commission finds that it will (1) significantly impair the utility's ability to raise necessary capital on reasonable terms or (2) fail to maintain a reasonable capital structure. The financing structure of the Joint Applicants' proposed reorganization will result in a significant increase to the amount of debt at the parent company (to be known as "WEC Energy Group"). The financing plan accommodates the premium above prevailing book value that WEC agreed to pay to acquire Integrys' common stock. WEC Energy Group will take on $1.5 billion of acquisition debt to fund the purchase. The cash to service that debt will come from its utility subsidiaries, including Peoples Gas and North Shore GasThe analysis of whether ratepayers are at risk of adverse rate impacts includes consideration of the utility's access to capital and its other obligations due to existing and future debt. *Ill. Consolidated Telephone Co.*, ICC Docket. No. 02-0502, Final Order of December 17, 2002 at 25-26.

Peoples Gas and North Shore Gas currently access capital markets on reasonable terms. Staff Ex. 7.0 at 4:70-81. However, following the announcement of the proposed reorganization in June 2014, the ratings agencies downgraded their outlooks for Peoples Gas, North Shore and WEC. CUB Cross Ex. 3, JA MGM 1.15 Attach 02 at 3; 5-6; *see also* Staff Ex. 7.0 at 5:88-110, JA Ex. 3.0 at 24-26:477-524. The lower credit ratings projected by the ratings agencies will, all

else equal, lead to higher debt costs for the Companies. Higher debt costs would, in turn, lead to higher costs of both debt and equity. Section 7-204(b)(4) of the PUA prohibits the Commission from approving a reorganization if it finds that the transaction will significantly impair the utility's ability to raise necessary capital on reasonable terms or to maintain a reasonable capital structure. 220 ILCS 5/7-204(b)(4). Given the credit rating agency outlooks and the Joint Applicants' failure to provide any evidence regarding the existence or significance of any negative effects, the Commission cannot find, at this time, that the reorganization will not significantly impair NS and PGL's ability to raise capital. The reorganization is denied as failing to meet the statutory criteria of 7-204(b)(4).

Dividend Payout Restrictions are Necessary, If the Reorganization Is Approved

City/CUB witness Mr. Gorman suggested that, if the proposed reorganization is approved, "ring-fence protections," also known as "dividend payout restrictions," to assure that utility cash flows will be used to avoid diminished utility service first, before dividends to serve parent company financial obligations. Specifically, Mr. Gorman recommended that dividend payouts of Illinois utilities should be restricted if Illinois utilities do not fulfill their obligations (both in amount and as to timing) to make capital improvements to their distribution systems. City/CUB Ex. 4.0 at 21-22:517-522, City/CUB Ex. 8.0 at 7:142-145. This would ensure prioritization of the Companies' ability to fund capital programs, which enhance system safety and reliability, above funding the acquisition-related debt created by this proposed reorganization. City/CUB Ex. 4.0 at 22:522-526. Otherwise, say City-CUB, Illinois ratepayers will be less protected from the effects of this proposed reorganization than Wisconsin ratepayers, and less protected than they are currently. *Id*. at 22:526-528.

City-CUB point out, as an initial matter, that WEC is a holding company, completely dependent for its debt coverage on the ability of its subsidiaries to pay amounts to WEC through dividends or other payments. City/CUB Ex. 4.0 at 14:316-321. WEC currently pays public dividends to its shareholders. Post-reorganization, WEC has indicated its intention to pay increased dividends per share at the same time that it will also have to pay the debt service (principal and interest) on the $1.5 billion of new reorganization debt. *Id*. at 333-336. If WEC requires its utility subsidiaries to pay up higher dividends to cover increased obligations, the cash flow available for those utilities' modernization investment and service operations is reduced. *Id*. at 15:348-349; also Tr. 133-134, 137 (Schott) (utilities do not dictate their own dividend policies, independent of their holding company). City-CUB aver that, if the dividend payments from Peoples Gas, specifically, are increased, reduced funds available for PGL's system investment could delay implementation of the necessary and Commission-required AMRP. *Id*. at 15:348-350.

Alternatively, as the Joint Applicants' Mr. Reed suggests (JA Ex. 8.0 at 20:398), Peoples could go to the market for external debt to fund AMRP. However, state City-CUB, that alternative could erode their credit rating and increase its cost of debt. Such adverse effects on the utility's financial position would preclude satisfying the threshold Section 7-204(b)(4) requirements, and the resulting harm to the ratepayers who will have to pay increased capital costs in rates would violate the Section 7-204(b)(7) criterion. *Id*. at 15:351-352.

City-CUB witness Mr. Gorman assessed whether the projected level of dividend payouts from the utilities to WEC could support both WEC's increased dividend payouts and service on the reorganization debt service, under the proposed reorganization. Mr. Gorman compared the

forecasted level of utility dividend payments up to WEC (post-merger) with the amount of cash WEC needs to (1) pay its public dividends and (2) service the $1.5 billion acquisition-related debt. City/CUB Ex. 4.0 at 362-366. WEC will also have to service parent company debt that existed prior to the merger, meaning that WEC's incremental reorganization debt service will have to be funded from new subsidiary payments. Even when Mr. Gorman's very conservative assessment left that consideration out of his analysis, thus understating the pressure on WEC's utility subsidiaries for cash flow, the analysis shows a persistent need to extract more in payments from the utilities. *Id*. at 15-16:366-370. City-CUB argue that, since the Commission cannot find that the proposed reorganization financing "will not diminish" the utilities' ability to meet its statutory service obligations, the proposal presents an unlawful risk that bars approval. 220 ILCS 5/7-204(b)(1) (emphasis added).

City-CUB Ex. 4.1 shows projected utility cash dividend payments to WEC Energy Group for the period 2015-2018. City-CUB Ex. 4.0 at 16:372-374. Mr. Gorman's analysis showed that WEC's planned dividend payments from utility subsidiaries up to WEC may not be adequate to pay planned increased shareholder dividends, service existing debt, and simultaneously service the $1.5 billion in reorganization-related debt. *Id*. at 16:381-384. Thus, Peoples and North Shore may be required to make increased dividend payments up to WEC, beyond what is currently contemplated under the proposed reorganization. *Id*. at 16:390-392. City-CUB point out that the Joint Applicants' current dividend projections already assume that the Illinois utilities will pay out more of their earnings as dividends than they currently do—a projected total of 89% of their earnings. *Id*. at 17:406-409, 18:421-422. For PGL, that is in comparison to an average of 59% of their earnings over the past five years. City/CUB Ex. 4.1 at 1. City-CUB note that such dividend payouts leave less internal cash available to the Companies to support their own needs, such as critical capital investment programs, including AMRP. City/CUB Ex. 4.0 at 16-17:392-397.

Moreover, argue City-CUB, the danger of service-affecting cash extractions is greater for Illinois utilities than for other utility subsidiaries. S&P, Moody's, and Fitch have all remarked on the magnitude of WEC Energy Group's increased financial obligation following the merger, and on the fact that WEC Energy Group's only source of cash will be its utility subsidiaries. *Id*. at 18:430-432. However, the Public Service Commission of Wisconsin ("Wisconsin PUC") has the authority to restrict Wisconsin subsidiary utility payouts in the form of dividends if certain financial metrics are not met. *Id*. at 18-19:435-441. City-CUB point out that Illinois has no comparable regulatory mechanism in place. Fitch observed that the credit ratings of the Wisconsin utilities will be unaffected, since "[r]egulatory restrictions regarding upstream dividend distributions to WEC provide some level of credit protection and mitigate contagion risk to the utilities from higher leverage at the parent." CUB Cross Ex. 3, Att. 03, p 1. As the ratings agencies have noted, WEC Energy Group's level of post-reorganization debt will be so great that under-performing projections will require more from the utility subsidiaries. *Id*. at 21:496-498. Thus, say City-CUB, Illinois subsidiaries could be in the position of shouldering an even greater burden when Wisconsin subsidiaries and their customers are protected by dividend restrictions and -- absent Mr. Gorman's proposed reorganization approval conditions -- Illinois companies and customers are the principal remaining source of cash.

The Joint Applicants correctly recognize that Mr. Gorman's ring-fence protection is intended to protect the Gas Companies' system modernization programs to ensure they are given higher priority than the payment of dividends from the utilities to their parent company following

the proposed reorganization. JA Init. Br. at 45. However, the Joint Applicants suggest three reasons why they assert Mr. Gorman's condition is not necessary: (1) the reorganized parent company will be financially stable enough, (2) other Joint Applicant commitments ensure continued investment in the utility infrastructure, and (3) Section 7-103 of the PUA allows the Commission to halt dividend payments that would impair a utility's ability to make necessary capital investments. JA Init. Br. at 46-48. CUB-City refuted each of those arguments.

a. Financial Strength of WEC Energy Group

City-CUB note that the proposed financing structure of the merger will significantly increase the amount of debt at the parent-company level. WEC plans to issue new WEC stock and $1,500,000,000 of acquisition debt to finance the proposed reorganization. City/CUB Ex. 4.0 at 13:309-310. As a holding company, WEC's only source of cash to service the acquisition debt will be cash dividend payouts from its utility subsidiaries, including NS and PGL. *Id*. at 13:313-314. City-CUB aver that, if WEC's cash flow does not meet its current expectations, WEC will be compelled to withdraw more cash (i.e. require larger dividend payments) from its utility affiliates to satisfy the financial obligations created by this transaction. *Id*. at 13:296-299. Without the ring-fence protection proposed by Mr. Gorman, City-CUB argue that WEC could force NS and PGL to increase dividend payments, so long as they do not cause material financial distress to the companies, even if that means lessening their infrastructure investments like AMRP.

City-CUB maintain that the outlooks published by the credit ratings agencies do not agree with the Joint Applicants' assertion that the reorganization will result in a stronger holding company with improved access to capital markets. *See* JA Init. Br. at 46. To the contrary, the ratings agencies placed WEC on credit watch with negative implications, meaning a credit down grade may occur as a result of this reorganization. CUB Cross Ex. 3, JA MGM 1.15 Attach 01-03. City-CUB acknowledge that, it is true that, *if* things go as the Joint Applicants project, they *should* have adequate cash flows to support their acquisition-related debt without compromising capital improvement funds. In such circumstances, Mr. Gorman's ring-fence provision would not be invoked and would cause no harm. On the other hand, contend City-CUB the Joint Applicants' own projections suggest that there may be limitations on the availability of cash flow to utility companies, so that cash flow will instead be available to support parent-company leverage financial obligations. *Id*. at 13:261-263. City-CUB note that The enormous acquisition debt being undertaken by the WEC Energy Group is a burden not currently felt by WEC. *Id*. at 13-14:278-282. City-CUB contend that their ring-fence provision acts as insurance to protect customers in the event that the Joint Applicants' expectations are not met. City/CUB Ex. 8.0 11:226-235. Moreover, say City-CUB, if the Joint Applicants' forecasts do turn out to be correct, the ring-fence protections will have a *de minimis* impact on their financing and capital investment plans. *Id*. at 11:226-235. Thus, given the Joint Applicants' apparent certainty of their future financial strength, they should have no objection to a condition they assert will never come into play. City-CUB argue that the ring-fence provision operates as a safety valve to protect utility capital projects from being underfunded and safety and reliability being compromised if the Joint Applicants' forecasts are incorrect. *Id*. at 11-12:236-244.

City-CUB aver that the supposed financial benefits touted by the Joint Applicants (a "<u>stronger</u> more financially stable holding company with both <u>greater</u> financial liquidity and <u>improved</u> access to capital markets" (emphasis in original)) have never been proven in this case. The Joint Applicants have never provided – even in response to a discovery request specifically

requesting such – any concrete mechanisms by which those benefits will be realized or how they will benefit their Illinois subsidiaries and ratepayers. City Group Cross Ex. 1, JA-City 7.02 and 10.54. City-CUB argue that it is simply unproven and uncertain whether the financial stability the Joint Applicants expect will indeed come to fruition. In the possible, if not likely, event that the Joint Applicants' expectations are overly optimistic, ring fence provisions ensure continued infrastructure modernization investment is not jeopardized in favor of servicing parent-company debt undertaken to finance this transaction.

b. Joint Applicant Commitments Are Inadequate

City-CUB also respond to the Joint Applicants' suggestion that their proposed commitments make Mr. Gorman's proposal unnecessary. The Joint Applicants' financing experts identified those commitments as the proposed AMPR commitments, "most specifically Commitment No. 5." City-CUB respond that the proposed Commitment No. 5 is a conditional, unmeasurable promise to "continue the Accelerated Main Replacement Program ("AMRP"), assuming it receives and continues to receive appropriate cost recovery." JA Ex. 15.1 Rev. The Joint Applicants' quantified investment commitment must cover not only PGL's AMRP, but all other investment requirements as well. Moreover, say City-CUB the funding commitment would last for only three years of the decades of investment and construction required to complete PGL's AMRP project.

City-CUB acknowledged the Joint Applicants' argument that other commitments they have made provide adequate assurance that their infrastructure investment will be "reasonable and appropriate." JA Init. Br. at 47. The Joint Applicants point to their commitments to continue AMRP – provided they receive what they deem to be appropriate cost recovery – and to spend minimum amounts on capital expenditures. *Id.*, *citing* JA Ex. 15.1 Rev., Commitments 5 and 13. They also cite their conditional commitment to implement the final recommendations from the Liberty Audit. JA Init. Br. at 47 citing JA Ex. 15.1 Rev. Commitments 7, 9-11, 35. None of the commitments cited by the Joint Applicants provide the same assurance as the ring-fence provisions proposed by Mr. Gorman.

City-CUB respond that the majority of those commitments are heavily-conditioned. While the Joint Applicants purport to commit to continue the AMRP, that is only "assuming it receives and continues to receive appropriate cost recovery." JA Init. Br. Appendix A at 1, Commitment 5. Additionally, say City-CUB, the Joint Applicants' capital investment commitments are only effective for *three* years – 2015 through 2017, a small fraction of the remaining AMRP implementation period. *Id.* at 2, Commitment 13. The Joint Applicants' commitment to implement recommendations in the final Liberty Audit is also heavily conditioned (recommendation will be implemented if it is possible, practical, reasonable, cost-effective, as determined by PGL). *Id.* at 2, Commitment 9. City-CUB acknowledge that the Joint Applicants commit to cooperate with Staff, but only to the extent that "cooperation" meets their 82-word definition. *Id.* at 2, Commitment 10. They commit to provide reports regarding any change in implementation of the recommendations in the final Liberty report, but only to the Commission – not to the essential stakeholder, the City of Chicago. *Id.* at 2, Commitment 11. City-CUB point out that the Joint Applicants' commitment to "review and attempt to improve" their AMRP performance is without a single metric or benchmark. *Id.* at 5, Commitment 35.

Clearly, say City-CUB, the commitments cited by the Joint Applicants as purportedly obviating the need for ring-fence provisions do not provide anywhere near the level of assurance

of continued infrastructure improvement investment as Mr. Gorman's proposals. City-CUB maintain that the commitments are so broad and heavily-conditioned as to be easily avoided by WEC Energy Group if it experiences unexpected financial difficulty. City-Cub argue that a Commission Order that explicitly includes Mr. Gorman's ring-fence provision is the only way to ensure that the utilities' system modernization programs are prioritized over the payment of dividends up to the parent company.

c. Section 7-103 of the PUA Does Not Protect AMRP Investment

The Joint Applicants' third and final argument against Commission-ordered ring-fencing provisions is that Section 7-103 of the PUA authorizes the Commission to limit the payment of dividends in certain circumstances. JA Init. Br. at 47-48. City-CUB aver that, if that section of the Act truly provided the same protections as the ring-fencing provisions provided here, the Joint Applicants should have no qualms with a redundant condition in the Order of this case. However, that is clearly not the case.

City-CUB note that the PUA statutory provision authorizing the Commission to limit the payment of dividends is not adequate to ensure that system improvements for safety and reliability are given higher priority than parent-company dividends. First, the Commission may order a utility to cease and desist payment of dividends only if the Commission finds that the capital of a utility has (effectively) already become impaired:

> No utility shall pay any dividend upon its common stock and preferred stock unless:
>
> (a) The utility's earnings and earned surplus are sufficient to declare and pay same after provision is made for reasonable and proper reserves.
> (b) The dividend proposed to be paid upon such common stock can reasonably be paid without impairment of the ability to perform its duty to render reasonable and adequate service at reasonable rates.
> (c) It shall have set aside the depreciation annuity prescribed by the Commission or a reasonable depreciation annuity if none has been prescribed.

220 ILCS 5/7-203(1), (2). If a wholly owned utility subsidiary is compelled to pay out dividends despite not meeting any of the above requirements, this provision becomes operative. Though the utility is required to give the Commission at least thirty days' notice if it plans dividends while under financial stress, no notice is required if the utility does acknowledge that the dividend would trigger the section 7-203 constraints. City/CUB 8.0 at 9:189. In either case, note City-CUB, Staff's finance expert testified that the extraordinary assessment required to support a Commission order stopping the dividend payments would likely take longer than the brief period provided by the notice. Tr. 534 (McNally). City-CUB maintain that PUA dividend restrictions only protect the financial integrity of a utility during specifically defined periods of financial distress, and even that protection may not be timely.

City-CUB note that, under the PUA's provisions, Illinois utilities could meet the statutory requirements for avoiding Commission dividend constraints, but still not be able to pay the

planned dividends and simultaneously meet their system investment needs. Under holding company pressure, a utility may choose to make a dividend payout (or an increased dividend payout) rather than meet its full obligations to make capital improvements that enhance safety and reliability. City/CUB Ex. 8.0 at 10:195-202. Mr. Gorman explained:

> The PUA dividend restriction is based on whether or not there are adequate earned surplus or retained earnings to permit the utility to pay dividends. This is a far different standard than receiving a bonafide assurance from the Joint Applicants that meeting their system modernization capital program will have a higher priority than making dividend payments up to WEC. This is particularly important since WEC will be taking on additional significant financial obligations as a result of its funding sources for the proposed transaction.

City/CUB Ex. 8.0 at 9:180. The statutory dividend provisions provide ratepayers far less protection than Mr. Gorman's proposed dividend payout restriction.[1] Indeed, they provide no assurance that programs like the AMRP will have a higher priority than dividend payments up to WEC Energy Group.

The PUA dividend restriction is based on whether or not there are adequate earned surplus or retained earnings to permit the utility to pay dividends – a far different standard then assuring that system modernization capital programs will have a higher priority than making dividend payments. City/CUB Ex. 8.0 at 9:180-184. Additionally, Section 7-103 is only operative if the Commission has *already found* that the capital of a public utility has become impaired or will become impaired by the payment of a dividend. 220 ILCS 5/7-103(1). For the Commission to act preemptively, the Commission must have notice of impaired finances prior to the dividends actually being declared or paid. However, the PUA only requires a utility to give the Commission advanced notice of planned dividend payments if the payments are not consistent with the statutory criteria in 7-103(2). Those criteria do not consider system improvements such as AMRP – only that dividend payments will not impair the ability of the utility to "perform its duty to render reasonable and adequate service at reasonable rates." 220 ILCS 5/7-103(2)(b). That is, the PUA restriction is designed to protect the financial integrity of a utility only during financial distress periods.

City-CUB note that Staff witness Mr. McNally took no position on Mr. Gorman's proposal in his written testimony. He agreed, however, that Section 7-103 of the PUA is not preemptive, and thus recommended that, if Mr. Gorman's proposal is not adopted by the Commission, the Commission should require the Joint Applicants to file copies of all credit agency reports for NS and PGL and WEC Energy Group with the Commission within five business days of publication "so that the Commission can act on its authority under 7-103 in a timely manner." Staff Ex. 13.0 at 6:127-134. Section 7-103 does not require that the utility provide the Commission with advanced notice of its intention to declare and pay a dividend (220 ILCS 5/7-103), and generally does provide notice that a utility is in fact going to declare and pay

[1] The PUA's provisions also provide less automatic protection to Illinois ratepayers than Wisconsin ratepayers will enjoy. There is no reason Illinois ratepayers should have less protection than Wisconsin ratepayers in this reorganization. The Commission has the authority to equalize this risk to ratepayers by adopting Mr. Gorman's dividend restriction as a condition of any approval.

a dividend until that information has been made public. Tr. 532. At that time, it is likely too late for the Commission to act on its 7-103 authority to prohibit payment of dividends. Mr. McNally's proposal provides no assurance that the Commission will learn of the financial impairment of a utility until dividends have already been paid, and there is no recourse at that point. Mr. McNally's alternative condition does not provide nearly the level of ratepayer protection as Mr. Gorman's proposal.

City-CUB contend that, if the proposed reorganization is approved, Mr. Gorman's ring-fence provisions are the only way to ensure that infrastructure modernization is prioritized over dividend payouts to WEC Energy Group. The Joint Applicants' expectations of their financial stability, their other commitments, and the PUA provision do not provide the same assurances for Illinois utilities and ratepayers as Mr. Gorman's proposal. The Joint Applicants themselves have stated that "there are no specific plans at present time with respect to the use of WEC Energy Group's cash flows for the funding of the Peoples Gas AMRP." City Group Cross Ex. 1, JA-City 2.22. No existing Joint Applicant commitments or regulatory provisions assure anything akin to AMRP prioritization over dividends. If they did, the Joint Applicants would have no reason to oppose the ring-fence provision, as it would never need to be invoked.

In sum, City-CUB aver that, as condition of any Commission-approved reorganization, funding for the Companies' capital programs should be prioritized over dividend payments up to WEC Energy Group, in a clear commitment with defined and enforceable consequences for violation. City-CUB argue that this condition will act as insurance to protect customers, in the event the expected outlook for the Joint Applicants' cash flows and ability to fund capital improvement plan are weaker than forecasted by the Joint Applicants. City/CUB Ex. 8.0 at 11:231-234. To the extent that the Companies' obligations regarding system modernization capital programs are not met, the City-CUB contend that Companies' dividend payouts should either be limited or eliminated. The dividend restrictions, which would prevent dividends that compromise infrastructure investment in the first instance, should remain in effect as long as the Qualifying Infrastructure Plant rider program is in effect. City-CUB emphasize that the safety and reliability of the Companies' distribution systems should be prioritized over dividend payouts to the out-of-state parent company.

Commission Analysis and Conclusions

The evidence of record demonstrates that there is real risk that the proposed WEC Energy Group will be forced to extract additional cash from its utility affiliates, above and beyond what has been proposed in this case, if cash flow is not realized as projected by the Joint Applicants. City-CUB Ex. 4.0 at 13:295-299; City/CUB Ex. 8.0 at 13:261, 270. The safety and reliability of the Companies' distribution systems should be prioritized over dividend payouts to the out-of-state parent company. Therefore, as a condition of the reorganization, the Commission requires that funding of utility infrastructure modernization, including AMRP, shall not be diminished (adversely affecting planned infrastructure modernization programs, spending or timelines) by a utility's dividend payments. To ensure that is the case, Peoples and North Shore shall not make dividend payments to their parent company without 90-days' prior notice to the Commission , so that the Commission can assure that planned dividend payments do not have a prohibited impact.

E. Section 7-204(b)(5) -- remain subject to Illinois utility laws and policies

City/CUB Position

City/CUB noted that under Section 7-204 of the PUA, the Commission has conditioned approval of a reorganization on the commitment of PGL and NS to propose $7.5 million of energy efficiency programs. City/CUB also observed that the Commission has conditioned approval or a reorganization on a requirement that the subject utilities ensure certain specific funding levels for energy efficiency. City/CUB also noted that the ICC has issued its own report making clear that the Commission has an active role, even in non-EEPS proceedings, to contemplate the effect on energy efficiency of its various orders.

City/CUB argued that, as a condition of any approved reorganization, the Commission should require:

- an additional contribution of $10 million in energy efficiency programming funded by Wisconsin Energy's shareholders
- changes to PGL and NS's On Bill Financing programs to allow more ratepayers to access the program and to fund a greater number of measures
- the creation and maintenance of an electronically accessible energy use database for aggregated, building-level energy use
- the creation of an updatable database of actual usage patterns for all ratepayers of PGL and NS; and
- the issuance of a public report examining the costs and benefits of implementing energy efficiency programming through a third party.

City/CUB Ex. 3.0 at 40-53.

City/CUB noted that the only way to assure the Commission and Illinois ratepayers that the Joint Applicants' "concerted effort" will materialize into clear favorable results is a Commission requirement to make expansion permanent.

Ms. Weigert concluded that PGL and NS can achieve greater savings, even within the budget constraints of the legislation by pursuing more energy efficiency programming. City/CUB Ex. 2.0 at 75-77. City/CUB pointed out that the proposed reorganization "presents the possibility that the excess of ratepayer contributions over delivered utility programs will become just another revenue stream flowing out of Chicago to the proposed acquiring company." City/CUB Ex. 2.0 at 122-124. City/CUB noted that it is *discretionary* whether to use EEPS funds to achieve additional savings and how to achieve those additional savings once reduced EEPS targets have been met. City/CUB Ex. 6.0 Rev. at 56-59. Even with Rider VBA intact, City/CUB argued, the Joint Applicants have not rebutted the fact that demand drives additional investment in the gas distribution infrastructure on which the utility earns a mandated return and that removing a disincentive against lowered consumption is not the same as incentivizing additional energy efficiency savings. City/CUB Ex. 6.0 Rev. at 163-167. City/CUB observed that the record contains no indication that Wisconsin Energy, after approval of a reorganization, will be more inclined (than PGL has been) to honor the aims of Section 8-104 and use all the funds collected from PGL ratepayers for effective programs to reduce energy use and to lower bills.

City/CUB also noted that low participation has been a problem for PGL's OBF program. City/CUB observed that the Commission has indicated that it shares the concern around low participation and looks forward to ways to address that problem. *Ill. Commerce Comm'n On Its Own Motion,* ICC Dkt. No. 11-0689, Final Order of May 15, 2013 at 7. City/CUB argued that given the extraordinarily low rate of loss (less than 1 percent), PGL's OBF program should be

expanded to include those ratepayers who may not qualify based on their credit history but may qualify based on their bill payment history. City/CUB Ex. 2.0 at 311-314. City/CUB concluded that PGL and NS have more than enough precedent to request the changes Ms. Weigert recommended.

City/CUB observed that while PGL created a system earlier this year to offer basic aggregate energy usage data for buildings, it is only partially automated and does not offer the year round functionality of ComEd's EUDS. *Id*. at 236-238. The manual process in place today, which requires a user to wait up to a week for data, requires input, time, and effort of actual personnel, noted City/CUB. City/CUB Ex. 6.0 Rev. at 172-174. As the City's Benchmarking Ordinance expands over time to cover hundreds of additional buildings in 2015 and 2016, Ms. Weigert noted that the manual processes will become even more resource intensive. City/CUB Ex. 6.0 Rev. at 176-178. In contrast, City/CUB noted, an automated system would eliminate much of that time and effort. City/CUB Ex. 6.0 Rev. at 178-179. In addition to the usage data gathered in compliance with the Ordinance, City/CUB noted that the City has also developed a database to analyze Chicago's energy usage (both gas and electric) on a block-by-block basis. City/CUB Ex. 2.0 at 239-241. Ms. Weigert noted that detailed data, such as the usage data used for this portal, is required for any successful research program, especially those which seek to improve the savings received from energy efficiency and dynamic pricing programs. City/CUB Ex. 2.0 at 247-250. Thus, City/CUB argued, the Joint Applicants should be required to offer a ComEd EUDS-like system to access aggregated natural gas usage data for buildings that is fully automated, timely, and offers billing quality data and which includes full technical support. City/CUB Ex. 2.0 at 256-257. In addition, City/CUB argued, the Joint Applicants should be required to work with the City and its academic research partners to create an ongoing, updatable database of actual natural gas usage data that protects the privacy of ratepayers. *Id*. at 262-264.

City/CUB also noted that the third party administrator model of energy efficiency removes the overarching disincentive to reduce energy use and allows the administrator to champion and implement programs that will be successful in reducing overall energy use. City/CUB Ex. 2.0 at 189-191. A third-party administrator would maximize reductions in energy use, would align closely with the common goals defined by the General Assembly for the gas EEPS and the recent decisions of the ICC to encourage greater energy efficiency, City/CUB observed. *See* 13-0550 Final Order at 26-27, 64. Thus, argued City/CUB, the Commission should order that that the Joint Applicants fund a study of the potential costs and benefits of third party administration of PGL and NS EEPS programs. *Id*. at 205-210. City/CUB noted that Illinois ratepayers deserve no less than Wisconsin ratepayers in terms of effective energy efficiency initiatives.

Commission Analysis and Conclusions

The Commission finds that, without including the conditions proposed by City/CUB, the Commission cannot conclude that the proposed reorganization will allow PGL and NS to comply with Illinois policy and Commission orders regarding energy efficiency. The record evidence demonstrates that the new proposed ownership does not view energy efficiency in the same way Illinois policy has been developed and implemented. Without approval pursuant to City/CUB's proposed conditions, PGL's energy efficiency funding could become just another revenue stream flowing out of the state. To protect against this possibility, the Commission hereby adopts City/CUB's proposed conditions.

F. Section 7-204(b)(7) -- adverse rate impact not likely

City-CUB Position

1. Transition Cost/Savings Tracking and Rate Treatment

City-CUB argue that the protocols for ratemaking treatment of the costs of integrating the Joint Applicant firms into a single reorganized entity -- which the Joint Applicants call "transition costs" -- are an essential, but poorly defined process that cannot support the required Commission finding that adverse rate impacts are not likely. 220 ILCS 5/7-204(b)(7). In fact, according to City-CUB, development of a cogent process was an after-thought, wholly neglected until the Joint Applicants were prodded by advocates for affected ratepayers. Tr. 408 (Reed). The details of the process are few and hastily cobbled together; basic cost identification, tracking, and accounting processes are still lacking, according to City-CUB, and the Joint propose to Applicants leave tens of millions in potential rate increases subject to *ad hoc* processes to be defined during a future rate case. Tr. 403 (Reed).

City-CUB argue that the required Commission finding must be made in this case, and the Joint Applicants' proposal, commitments, and evidence do not provide adequate support for that finding. On examination of the record, it appeared to City-CUB that the Joint Applicants' preparations are not adequate to assure that post-reorganization rates will not improperly recover costs prohibited by Section 2-704, or by the Joint Applicants' own commitments.

a. Background

City-CUB provided a background description of transition costs (distinguished from transaction costs) and the issues surrounding them in this case:

> The Joint Applicants distinguish two types of reorganization costs. The first category of costs comprises fees and expenses incurred to complete the paper transaction that will formally transfer ownership of the shares in Integrys to another entity controlled by WEC. City Group Cross Ex. 1, JA-City DRR 6.08. Under the reorganization proposal -- and consistent with past Commission treatment of such "transaction costs" -- these costs will not be recovered through rates from regulated utility ratepayers. JA Ex. 15.1 Rev., Commitments 16, 17 and 20. The Joint Applicants have made this a formal part of their reorganization proposal through commitments that are to be made part of the order approving the reorganization, if it is approved. JA Ex. 15.1 Rev., Commitment 16 and n. 2.
>
> The costs associated with the transformation of formerly separate organizations into a new integrated corporate organization make up the second category of costs. The Joint Applicants call these costs "transition costs." City Group Cross Ex. 1, JA-City DRR 6.08. Under the proposed reorganization, as clarified by the Joint Applicants' commitments, the Joint Applicants expect to receive rate recovery of some (perhaps most) transition costs. Tr. 384-385

(Reed). To help their proposal meet the Section 7-204(7) requirement that adverse rate impacts for utility customers must be unlikely, the Joint Applicants augmented the proposal with two transition cost-focused Commitments. According to those Commitments, transition costs will be identified, tracked, and accounted for in a manner that assures the Commission that transition costs are recovered only to the extent of the associated "net savings."

> Commitment 17. The Gas Companies shall separately track identify and track transaction costs and transition costs.
>
> Commitment 21. Transition costs may be recoverable to the extent the transition costs produce savings. JA Ex. 15.1 Rev.

City-CUB understand the Joint Applicants' concept of "net savings" to represent a calculation of savings minus costs, for the relevant asset or initiative and time period; it is the concept that the Joint Applicants propose to use in determining which costs may properly be recovered from utility ratepayers. *Id.*, Commitment 21; Tr. 369 (Reed). City-CUB contend that the Joint Applicants acknowledge the necessary consequence of that approach, which is that costs incurred for purposes other than the achievement of net savings are ineligible for recovery from utility ratepayers. Tr. 371 (Reed). City-CUB understand the Joint Applicants' testimony to state that where initiatives (and implementation costs) are necessitated by the reorganization, but are implemented for reasons other than to achieve savings -- e.g., moving all companies to a common accounting system, or relocating organizational elements for management cohesion -- such costs will be separately identified and excluded from the amounts eligible for possible rate recovery. In addition, City-CUB say, the utilities expect that some transition costs of affiliated companies will be allocated to the utilities, and such allocated transition costs will be subject to the same tracking protocols, eligibility criteria, and ratemaking proofs as a utility's own transition costs. Tr. 372-373 (Reed).

b. The Joint Applicants' Proposed Ratemaking Treatment

City-CUB contend that the Joint Applicants' proposal presents problematic identification, tracking, and rate recovery issues related to costs for the post-closing process of melding separate corporate entities into an integrated organization. According to City-CUB, these issues relate directly to the rate impacts of the proposed reorganization, and many of the problematic issues are direct results of the Joint Applicants' strategic decision to delay planning and preparation for that assimilation process. *See Joint Applicants-Commissioners DRR No. 1*. City-CUB assert that the Joint Applicants' decision not to develop transition plans and estimates of costs or savings avoids any up-front allocation of estimated savings and risk to the Joint Applicants, but that decision necessitates far more complex and uncertain ratemaking mechanics. City-CUB assert that the most important consequence is the need to have in place -- from the beginning of the transition (the closing) -- rigorous protocols for accurate identification, classification, and calculation of costs eligible for rate recovery, to assure that adverse rate impacts on retail customers are not likely.

City-CUB assert that the Joint Applicants' ill-defined proposals do not assure the result required by the statute. They argue that because of the structure of the proposal in this case, if the record is inadequate on any one of several points, the statutory requirement for a Commission finding that adverse rate impacts are "unlikely" cannot be met, and the reorganization cannot be approved. City-CUB observe that whether intended or not, the Joint Applicants' tactical delay in serious implementation planning has the effect of making all transition costs potentially recoverable through utility rates. Thus, they argue, to satisfy the threshold rate impact criterion for reorganization approval, the Joint Applicants' evidence must assure the Commission of (a) the improbability of reorganization related cost recovery that has an adverse impact on utility customers, (b) the certainty of compliance with transition cost Commitments incorporated in a reorganization approval order, and (c) the Commission's ability to accurately identify and quantify recoverable transition costs for lawful ratemaking, even in the absence of Commission-reviewed protocols for identifying and tracking transition costs and any associated savings.

City-CUB allege that the task of identifying, tracking, and properly classifying (for rate recovery eligibility) varieties of transition costs is neither simple nor routine for the utilities that must complete it, and that surprisingly the Illinois utilities are not involved in the just-begun development of those procedures. Tr. 408. (Reed: Reed and Lauber had two phone calls "right after we received 13.05")). City-CUB observe that transition costs may serve multiple functions and may be recorded, on a case-by-case basis, in various accounts, or separately from established accounts. Tr. 375. (Reed). Similarly, they say, transition costs may be incurred over a period of years, with an objective of achieving savings only in the long term. City-CUB also note that the still undefined accounting and recovery protocols must identify certain (also undefined) transition costs that may become ineligible for rate recovery only if they exceed a baseline, pre-reorganization level, and treat them differently, to exclude the "but for reorganization costs."[2] Tr. 371 (Reed). The associated "net savings" for each set of transition costs require similar identification, tracking, and accounting to determine the recovery cap, whether costs are tracked by initiative, asset, function, or other criteria, City-CUB note. Each of these variations (according to City-CUB) presents its own complexities and conundrums.

Adding another layer of complexity in any of the above circumstances City-CUB say, anticipated net savings may not be realized. City-CUB observe that where reliance on projected but un-achieved savings results in premature (and improper) recovery, meaningful enforcement of the commitment to cap transition costs at net savings would require an adjustment to past rate recovery, but that no such mechanism is available in current ratemaking processes or any Joint Applicants record testimony.

City-CUB observe that the Joint Applicants concede that the expected magnitude of the Joint Applicants' transition costs is significant; the Joint Applicants' reorganization expert, Mr. Reed, estimated that they could amount to "tens of millions" of dollars. Tr. 369 (Reed). City-CUB argue that timely establishment of rigorous accounting and classification protocols for such

[2] City-CUB contend the use of such total company benchmarks to track transition costs and savings is itself problematic under the Commission's interpretation of Section 7-204(b)(7). "Patently, the legislature intended that the Commission, through 7-204(b)(7), would only identify characteristics of the proposed merger that were likely to adversely impact rates in subsequent rate proceedings, and to withhold or condition merger approval - not establish rates - when such characteristics were present." *Nicor Merger* at 30. City-CUB state that the Joint Applicants have not addressed such a benchmark process in this record, much less shown it to be acceptable for ill-defined costs in a reorganization inquiry.

large amounts -- which the utilities plan to include in rates -- is essential to avoid severe, adverse impacts on utility customer rates, as well as misallocations of costs and possible cross-subsidization of non-utility activities. *See* Section 7-204(b)(2), (3), and (7).

City-CUB offered an examination of several ratemaking scenarios they deemed reasonable to anticipate, for which the Commission must find that adverse rate impacts are unlikely, as a pre-condition to reorganization approval. 220 ILCS 5/7-204(b)(7). According to City-CUB, the scenario exercise demonstrated that the Joint Applicants have not defined for the Commission's consideration as it assess the likelihood of adverse rate impacts any protocols adequate to assure proper ratemaking treatment of transitions costs involving negative net savings (Tr. 376 (Reed)), and the overlap of rate case test year rules and transition costs incurred across a period of years. In fact, according to City-CUB, whether combining transition cost protocols and test year rules is more likely or less likely to result in adverse rate impacts cannot be determined from this record. City-CUB argue that with no record description of the protocols, there is no basis for a finding that, in future rate cases, *ad hoc* transition cost recovery determinations will be sufficiently accurate and Section 7-204(b)(7) is satisfied with certainty. Similarly, City-CUB argue, when projected (as opposed to actual) net savings are used, as the Joint Applicants propose to do, the varying rates at which costs and savings accumulate (*see* City Group Cross Ex. 1, JA-City 13.05 (illustrating cost/savings patterns)) overlaid on rate case test years make the determination of the Commitment 21 cap on cost recovery (that is, the utility "may" recover costs up to the cap), especially problematic, since the only way to be certain of compliance is to calculate recoverable transition costs using achieved net savings, a ratemaking approach the Joint Applicants do not contemplate using. Tr. 380 (Reed)

City-CUB state that the Joint Applicants suggest that the Commission's decision to rely on projected amounts to set rates in a recent formula rate proceeding provides a solution to the problems created by its transition costs proposal. Tr. 381-382 (Reed) (referring to the amortization of merger costs in *Re Commonwealth Edison Company*, ICC Docket No. 13-0318 ("*ComEd Reconciliation")*, Final Order of December 18, 2013 at 22). However, City-CUB contend that the Joint Applicants are wrong, because the circumstances in that proceeding that underlay the Commission's decision are wholly inapposite.

First, City-CUB say, the case was a reconciliation proceeding in a statutory electric utility formula rate regime that has no application to any of the Joint Applicants. *See* 220 ILCS 5/16-101. According to City-CUB, the very presence of a statutory reconciliation process distinguishes the irreversible cost recovery of a rate case that must be assessed in this case. City-CUB add that the unique definition of recoverable costs in ComEd's statutory process (actual costs) does what the use of achieved savings (opposed by the Joint Applicants) would do for the cost recovery at issue in this case. Second, City-CUB state, the test for acceptable formula rate determinations is not the same as the statutory test of Section 7-204 -- whether adverse rate impacts are "not likely" -- and the Joint Applicants have provided no supporting decisional law. *Re Commonwealth Edison Company*, ICC Docket No. 12-0321, Final Order of December 19, 2013 at 79. City-CUB argue that the stricter standard of Section 7-204 requires that the Commission find affirmatively that under reorganization approval -- and the proposed ratemaking treatment of reorganization-related costs -- adverse rate impacts are unlikely. Given the absence of annual reconciliations, City-CUB argue, costs not limited by actual occurrence, and the irreversibility of rate determinations for the reorganized utilities, the likelihood of adverse rate impacts is considerable.

Finally, City-CUB note that the Joint Applicants suggest that the necessity of Commission approval in ratemaking proceedings virtually guarantees that adverse rate impacts are not likely. JA Ex. 8.0 (Reed) at 8:152. That is not correct, since the burden of identifying and challenging improper reorganization costs buried in various tracking schemes would be shifted to ratepayer advocates in future rate cases. As City/CUB expert Mr. Gorman explained:

> The burden of proving whether or not the transition costs incurred were prudent and reasonable and produce verifiable savings should not fall on other parties to the rate case. In the absence of suitable proof, any imprudent, unreasonable or unproven transition costs and any costs of achieving unproven savings, should be the responsibility of the Joint Applicants or the utility, not ratepayers.

City/CUB Ex. 8.0 5:99. In City-CUB's view, the complexities of determining properly recovered costs when costs and savings do not advance in lock step may be practically insurmountable, and it cannot be cured by a process that depends on under-funded ratepayer advocates or Commission Staff finding and correcting improper recovery is not one for which improper recovery (and adverse rate impacts) are not likely.

According to City-CUB, the Commission should reasonably expect that the Joint Applicants would (at the very least) be able to explain the framework of the process they claim can assure proper rate treatment of transition and transaction costs, thereby preventing adverse rates impacts, but the Joint Applicants were unable to do so. City-CUB found it telling that even with the uncertainty about the efficacy of their undefined protocols, the Joint Applicant witnesses rejected City/CUB proposals for firmer, more detailed commitments as a way to reduce the likelihood of adverse rate impacts. City-CUB ask: If the Joint Applicants do not trust their protocols, why should the Commission? Such evidence cannot support a finding that adverse rate impacts are unlikely. In City-CUB's view, the Joint Applicants own testimony calls into serious question the value of the Joint Applicants' proposed Commitment 17 regarding transition costs.

City-CUB argue that without any showing of a process for the identification, tracking, accounting, and ratemaking treatment of reorganization transition costs (and savings), Commission approval would be unlawfully based on pure speculation -- that the Joint Applicants will be able to devise and timely implement a system that solves the described problems so completely that adverse rates impacts become unlikely. In fact, City-CUB argue, it is at least as likely that in the absence of rigorous tracking -- in place from the beginning -- such problems will not even be uncovered, much less resolved without adverse rate impacts.

In City/CUB's view, the Joint Applicants have not developed or presented cost identification and ratemaking protocols adequate to support that threshold Section 7-204(b)(7) finding. City-CUB submit that the absence of a rigorous, effective cost/savings tracking process and the sheer complexity of managing ratemaking treatment of tens of millions in ill-defined transition costs and "net savings" (relying on the sparse resources of intervenors in the midst of a rate case) make adverse impacts <u>likely</u>.

b. City-CUB Response to the Joint Applicants' Arguments

City-CUB acknowledge that the Joint Applicants recognize the need for protocols to properly handle transition cost recovery (JA Init. Br. At 29), but assert that the Joint Applicants

ignore the need to have functioning protocols in place for the entire period transition costs and savings may need to be tracked. City-CUB assert that the evidence shows the Joint Applicants have not developed cost identification, tracking, and accounting protocols that can be in place -- at closing, when the transition begins -- to immediately begin tracking transition costs and savings. City-CUB also observe that the Joint Applicants' propose to delay their presentation of a method for tracking reorganization-related transition costs and savings until later utility rate cases, which would mean evaluation and approval no earlier than two years after the transition period begins. Tr. 403-404 (Reed). City-CUB contend that suggestions that adverse rate impacts will not occur are unsupported in the record.

According to City-CUB, the Joint Applicants suggest the delay in defining transition cost protocols is harmless, and that "Transition Costs incurred prior to the first rate cases . . . will not be recoverable from customers." JA Init. Br. at 30. However, City-CUB state that the Joint Applicants' promise silently assumes the existence (and accuracy) of an unspecified method of cost/savings tracking, accounting, and rate treatment during the period before it is presented for Commission review and approval. City-CUB state that the Joint Applicants do not commit to incur no transition costs until tracking and ratemaking processes are approved, and that without some protocols in place there is no way to determine whether improper costs are recovered from customers. In other words, there would be no way to identify and quantify what transition costs were incurred, when transition costs were incurred, or which initiatives or assets (and periods for determining savings) are associated with the costs and any associated savings. Without appropriate protocols in place for the entire transition period, the Commission could not determine whether transition costs are improperly included in rates. City-CUB argue that without examining such protocols, now, the Commission cannot find that "adverse rate impacts on retail customers" are unlikely." 220 ILCS 5/7-204(b)(7).

Second, City-CUB argue that the Joint Applicants' bare assertion that "net savings achieved in the future will flow through to ratepayers in future rate cases" does not provide a basis -- on this record -- for a Commission finding that adverse rate impacts are not likely. JA Init. Br. at 29; 220 ILCS 5/7-204(b)(7). Unlike prior Commission proceedings in which applicant reliance on such an assertion *was not challenged*, City-CUB assert this record details Joint Applicants' failure to develop protocols that will provide an accurate accounting of transition costs and savings, as well as possible rate impacts from the lack of protocols to assure that transition costs are not improperly recovered in rates.

City-CUB also contend that in this case, the proposed transition cost/savings treatment has features not addressed in prior Commission reorganization orders -- *e.g.*, only costs incurred specifically to achieve savings are recoverable, net savings determined simultaneously on project-by-project and baseline comparison bases, and a suggestion of corrections for unachieved projected savings. For these particular features of the Joint Applicants' proposal, City-CUB assert that the record shows that not even a coherent framework exists, much less a tightly-knit process for cost tracking, savings determinations, and ratemaking needed to support an evidentiary finding that adverse rate impacts are unlikely.

City-CUB assert that the Joint Applicants' experts were unable to describe basic principles that would define (a) the tracking methods to be used and (b) how special transition cost tracking protocols, rate case test year rules, and net savings determinations will fit together (if they can), and (c) the feasibility of using projected savings. *See* City/CUB Init. Br. at 68-77. According to City-CUB, the Joint Applicants rely inappropriately on mechanisms drawn from

statutory reconciliation processes, to manage corrections required when projected savings used to justify rate recovery are not achieved, since retroactive rate corrections are not available to the utilities and any improper cost recovery is irrevocable. Tr. 381-382, 391; City/CUB Init.Br. at 74.

According to City-CUB, the record shows that deficiencies in the Joint Applicants protocols were pervasive, and they were predictable, because the Joint Applicants began developing protocols for "tens of millions" in transition costs (and any associated savings) only when pressed for answers in the run-up to the evidentiary hearings. Tr. 408 (Reed). City-CUb assert that the protocols are not only incomplete, the Joint Applicants could not explain whether or how one could simultaneously apply their undeveloped, overlapping notions of test year rules, initiative tracking and baseline comparison mechanisms, and the unspecified protocols for cost/savings determinations, as they propose. City/CUB expert Michael Gorman testified: "without appropriate accounting requirements, any net savings that are realized outside the test year will completely flow to the benefit of the Joint Applicants."

City-CUB note that Staff's expert accountant Mr. Kahle observed that there is "work to be done," and that though more detail would help the Commission oversee the proposed process, it is apparently not available. Tr. 549 (Kahle). City-CUB observe that the Joint Applicants' own expert agreed with Staff's Mr. Kahle, conceding:

> Well, I would say there is a lot to be determined in future rate cases and the exact mechanics of how that's going to work really should be reviewed at that time with data that's real from the transition plan of the company.

Tr. 403 (Reed). However, City-CUB state, that measured admission overstates the validity of the Joint Applicants' approach, since the suggested use of "data that's real" begs the question by *presuming* the availability of accurately identified and tracked costs and savings data, something that cannot happen without appropriate protocols. City-CUB not that such protocols do not exist, and the Joint Applicants do not have a transition plan. Response to Commissioners' Data Request at 2.

According to City-CUB, the Joint Applicants' Initial Brief does not sort out the confusion left by their witnesses regarding the interplay of their overlapping cost/savings concepts, and it does not offer any clarifying explanation or argument that other parties can consider and respond to on this record. As a result, City-CUB say, the Commission cannot determine from the Joint Applicants' statements of intention -- without any actual protocols -- that the Joint Applicants can assure proper rate treatment of transition costs and no "adverse rate impacts on retail customers." 220 ILCS 5/7-204(b)(7).

c. The Joint Applicants' Incomplete (and Otherwise Deficient) Transition Costs/Savings Proposal Reflects a Lack of Diligent Preparation

City-CUB argue that the Joint Applicants' lack of diligence and thoroughness on transition cost/savings issues extinguishes any claim of reasonableness for a speculative assumption that the Joint Applicants will timely develop and implement the protocols needed to satisfy the statutory standards. According to City-CUB, the lack of diligence was established through the testimony of the Joint Applicants' own witnesses, and their admissions are evidence

that distinguishes this case from any prior reorganization proceeding. Here, City-CUB argue, there is no basis to speculate that whatever scheme the Joint Applicants ultimately cobble together will be adequate to assure that the reorganization "is not likely to result in any adverse rate impacts on retail customers," even though the rate impact could be in the tens of millions. 220 ILCS 5/7-204(b)(7). City-CUB add that even if the Joint Applicants could actually develop such a process, its deployment would not be timely and the Commission could not look back to identify transition costs and savings that were not properly tracked in the years before an approved process was in place.

d. City/CUB Do Not Oppose All Transition Cost Recovery -- Only Costs That Do Not Produce Verifiable Savings for Ratepayers

City-CUB emphasize that they do not oppose recovery of all transition costs, only transition costs that fail to produce savings for customers. AG Init. Br at 77. "Allowing for recovery of transition costs that are not fully offset by savings created specifically by those activities, will result in an increase (inconsistent with the JAs' commitment) in the revenue requirement and retail rates within a rate case." City/CUB Ex. 8.0 (Gorman) at 5:94-7:135. Moreover, in his testimony, Mr. Gorman insisted that the Joint Applicants have the burden of demonstrating that no transition costs are improperly being recovered in rate cases.

According to City-CUB, despite the deficiencies of the Joint Applicants' undefined methods for identifying and determining transition costs and savings highlighted during the cross-examination of their experts, the Joint Applicants experts declined any action to remedy the problems. *See* generally Tr. 367-409 (Reed) and Tr. 463-484 (Lauber). In a particularly telling refusal, City-CUB say, the Joint Applicants' witness Scott Lauber (the executive in charge of implementing the transition cost protocols) would not modify the Joint Applicants' transition cost commitment (Commitment 21) to match the language of the transaction cost ratemaking commitment (Commitment 16) -- specifically to conform the commitments so that the utilities would "demonstrate that such costs are not included in the rate case for recovery." Tr. 478-480 (Lauber). The Joint Applicants' apparent desire to preserve ambiguity in their transition cost commitment, which could affect tens of millions of dollars in costs and savings, is (according to City-CUB) a danger sign the Commission should heed.[3]

e. The Joint Applicants' Transition Costs/Savings Commitments Must Be Modified or Supplemented

If the Commission nonetheless approves the proposed reorganization, despite the undisputed lack of developed transition cost protocols, City-CUB ask that the Commission impose very clear, enforceable conditions to produce an order of even marginal sustainability. With respect to transition costs, City-CUB assert those conditions must have at least the following features.

- Assure that any risk that the Joint Applicants' yet-to-be-developed transition cost recovery protocols are inadequate falls squarely on the utility. At a minimum, the Joint Applicants' transition cost commitment

[3] City/CUB note that imprecision and ambiguity in the Joint Applicants' commitments has the practical effect of shifting risks to ratepayers, who must first establish the meaning of a commitment before a violation can be addressed.

(Commitment 21) must be modified to add a clear requirement that the utility seeking inclusion of transition costs in rates must "demonstrate that transition costs in excess of associated savings are not included in the rate case for recovery."

- The Joint Applicants must present for approval fully-developed transition cost protocols for Commission review and approval (in a contested proceeding) within 90 days of closing, so that valid accounting procedures are in place for the maximum feasible portion of the transition period.
- The Joint Applicants should be required to report on an annual basis an accounting of all transition costs and all savings (to date) that may later be used to justify transition cost recovery in a rate case. They should be accumulated on the same basis (e.g., initiative, asset, or baseline measurement) that will be used to define the net savings cap on cost recovery, as this is the only way to avoid later result-oriented calculations hidden in the complexity of overlapping (and possibly inconsistent) ratemaking concepts. For example, dealing with transition costs net savings that are realized at different rates would otherwise be impossible.
- The Joint Applicants should identify all transition costs in a rate case's test year costs, whether or not they are proposed for recovery, providing the Commission with a check on the accuracy and completeness of the defined protocols.
- "The Joint Applicants have committed that they will not seek to recover any portion of the "acquisition premium . . . ." JA Init. Br. at 26. However, the Joint Applicants are taking no steps to be able to identify and track effects of the acquisition premium on the utilities' costs of capital. City Group Cross x. 1, JA-City/CUB DRR 2.08. They should be required to do so.

e. The Joint Applicants' Transition Costs/Savings Commitments Must Be Modified or Supplemented

City-CUB argue that, if the Commission nonetheless approves the proposed reorganization, despite the undisputed lack of developed transition cost protocols, the Commission must impose very clear, enforceable conditions to produce an order of even marginal sustainability. With respect to transition costs, City-CUB recommends the Commission impose conditions that provide the following statutory and public interest goals:

- Assure that any risk that the Joint Applicants' yet-to-be-developed transition cost recovery protocols are inadequate falls squarely on the utility. At a minimum, the Joint Applicants' transition cost commitment (Commitment 21) must be modified to add a clear requirement that the utility seeking inclusion of transition costs in rates must "demonstrate that transition costs in excess of associated savings are not included in the rate case for recovery."
- The Joint Applicants must present for approval fully-developed transition cost protocols for Commission review and approval (in a contested

proceeding) within 90 days of closing, so that valid accounting procedures are in place for the maximum feasible portion of the transition period.

- The Joint Applicants should be required to report on an annual basis an accounting of all transition costs and all savings (to date) that may later be used to justify transition cost recovery in a rate case. They should be accumulated on the same basis (e.g., initiative, asset, or baseline measurement) that will be used to define the net savings cap on cost recovery, as this is the only way to avoid later result-oriented calculations hidden in the complexity of overlapping (and possibly inconsistent) ratemaking concepts. For example, dealing with transition costs net savings that are realized at different rates would otherwise be impossible.
- The Joint Applicants should identify all transition costs in a rate case's test year costs, whether or not they are proposed for recovery, providing the Commission with a check on the accuracy and completeness of the defined protocols.
- "The Joint Applicants have committed that they will not seek to recover any portion of the "acquisition premium . . . ." JA Init. Br. at 26. However, the Joint Applicants are taking no steps to be able to identify and track effects of the acquisition premium on the utilities' costs of capital. City Group Cross x. 1, JA-City/CUB DRR 2.08. They should be required to do so.

Commission Analysis and Conclusions

The Joint Applicants have distinguished transition costs from the transaction costs that have been clearly identified and will be excluded from ratemaking recovery. First, the transition costs that the Joint Applicants propose to be able to recover to the extent of associated net savings are not well-identified. Although the Commission has in the past approved a formulation like that the Joint Applicants propose, the record evidence in those cases was significantly different. In many of those cases, the anticipated savings were nil or minimal. Here the net savings that are to limit rate recovery are wholly unquantified, but the transition costs that the Joint Applicants propose to have eligible for rate recovery are in the tens of millions of dollars.

Second, in no prior case has the ratemaking treatment of such costs been as thoroughly examined. The gaps in the Joint Applicants' (and consequently the Commission's) understanding of the interplay of the many concepts the Joint Applicants propose to apply simultaneously is only partly developed and unexplained at a level that gives a clear picture of implementation. The Joint Applicants have not provided any evidence that the difficulties they could not explain away on this record have not been problematic for other utilities. However, even that evidence is of limited relevance, since, as City-CUB point out, the Joint Applicants' proposal includes unique elements and combinations that do not appear to have been issues in past cases.

In addition, the lack any urgency to develop protocols for these tens of millions in potential ratemaking costs and the inability of the Joint Applicants' two experts on this issue to explain their approach in any detail does not give the Commission confidence that the protocols will be well-developed and timely deployed. And the protocols at issue would directly affect the rates of Illinois utilities' customers.

On this record, the Commission cannot -- without unlawful and unsupported speculation -- find that protocols to identify, track, and account for transition costs in a way that would make adverse rate impacts unlikely. Indeed, as City-CUB argue, what costs are involved, whether they have been or will be exceeded by associated net savings, and what costs will be included in rates under the simultaneous application of undefined transition cost protocols and rate case test year rules cannot be determined under the record in this case. Similarly, an assessment concluding, at the statutory level of confidence, that adverse rate impacts are not likely is beyond what this record can support.

2. Length of Rate Freeze Commitment

The Joint Applicants lead their objections to City-CUB's proposed extension of the rate freeze with a diversion into yet another restatement of their commitment not to improve the Illinois utilities, referring to their oft-repeated assertion that the PUA requires only that the utility *status quo* be maintained – not improved. JA Init. Br. at 44. The Joint Applicants' first objection to City-CUB's proposed extension of the rate freeze demonstrates to City-CUB, once again, that the Joint Applicants' perception of the Commission's authority and obligations in this proceeding is unlawfully narrow. City-CUB claim it also shows that their arguments are illogically broad. City-CUB aver that the Joint Applicants fail to connect their objection to the rate freeze commitment they offered to help meet statutory approval requirements or to City-CUB's proposed modification. Assuming, arguendo, some statutory basis for the Joint Applicants' "no harm" standard,[4] it cannot apply to improvement of the Joint Applicants' own proposed conditions; at most, it applies to current utility operations.

More importantly, say City-CUB, the Joint Applicants miss the mark. What City-CUB and the AG seek in supporting an extension of the rate freeze in not an inequitable benefit for customers. City-CUB assert that the rate freeze is supported by the tremendous revenue stability provided to PGL through multiple risk-reducing rider mechanisms, (City/CUB Ex. 4.0 at 8:185-187), as well as by the Joint Applicants' claim that net savings are expected to accrue as a result of the merger (*see* JA Ex. 17.0, 5:83-87). City-CUB point out that the proposed transaction will benefit PGL's ultimate investors, and a longer base rate freeze will provide a concomitant benefit in the form of a consumer protection intended to protect utility customers from the burden of a fifth rate increase in just 7 years.

City-CUB argue that the Joint Applicants' arguments ignore two relevant provisions in the PUA that support the rate freeze extension. First, the Commission is required to find that the proposed reorganization is "not likely to result in any adverse rate impacts on retail customers." 220 ILCS 5/7-204(b)(7). If the post-reorganization company is operating as the Joint Applicants project, say City-CUB, it will be a stronger, more financially stable holding company, (JA Ex. 2.0 at 28:571-29:589), it will benefit from multiple revenue-stabilizing riders, and it will generate long-term net savings in non-fuel O&M expense. In such conditions, City-CUB aver it is not unreasonable to request a longer rate freeze period. Second, according to City-CUB, the Joint Applicants ignore the public interest standard explicitly referenced in Section 7-204(f), which allows the Commission to impose such terms, conditions or requirements as, in its judgment, are necessary to protect the interests of the public utility and its customers." *Id*. at 7-204(f). City-CUB therefore conclude that it is entirely appropriate for the Commission to protect utility

[4] As shown in City/CUB's initial Brief (at 2-6), "no harm" is not the standard for reorganization approval.

ratepayers from paying higher rates that could result if the reorganization does not produce the outcomes the Joint Applicants project.

City-CUB reason that the Joint Applicants cannot have it both ways: selling the reorganization as a transaction that will produce net savings to share with ratepayers, while insisting that such savings will not be recognized until well after the post-reorganization utility requests yet another rate *increase*. The general tenet of Joint Applicants' is akin to the adage "it takes [more ratepayer] money to make money [to share with ratepayers]." Here, City-CUB aver that it is not ratepayers that are the opportunists, as Joint Applicant witness Reed suggests, (JA Ex. 17.0 at 6:102-104), but rather the Joint Applicants, who claim the reorganization will benefit ratepayers, while simultaneously delaying planning to achieve savings, neglecting development of protocols to identify and track savings, and resisting any recognition of such savings until a post-reorganization rate case where ratepayers are faced with a rate increase that offsets savings.

Next, City-CUB point to Joint Applicant's argument that Mr. Gorman's proposal does not account for the fact that North Shore does not have a Rider QIP and that the cap in Rider QIP recoveries can only be reset by the filing of a rate case. JA Init. Br. at 45. According to CUB-City, the Joint Applicants apparently chose to ignore the contradictory record evidence (especially the evidence answering these concerns), relying instead on a regurgitation of just their own testimony.

Mr. Gorman testified that over 70% of PGL's capital investment expenditures are subject to recovery (with a return) through Rider QIP, and other revenue stabilizing mechanisms ensure recovery of other revenues. City/CUB Ex. 4.0 at 8:194-195, City/CUB Ex. 8.0 at 3:57-61. Mr. Gorman further testified that, for PGL, the rate base used to set base-rates will have little or no increase over the next five years, because the amount of capital expenditures to be recovered through base rates is approximately equal to the amount of annual depreciation expense recovered by the utilities each year in utility non-fuel revenue receipts. City/CUB Ex. 8.0 at 4:64-69. Finally, say City-CUB, though North Shore does not have a rider like Rider QIP in effect currently, it has other mechanisms, including Rider VBA, that, coupled with savings from the reorganization, make a five year rate freeze reasonable for North Shore as well. *Id*. at 4:72-78. City-CUB conclude that the Joint Applicants' reasons for objecting to the proposed five year rate freeze stand in opposition to the evidence on the entire record.

City-CUB challenge the Joint Applicants claim that updated CDOT regulations have imposed costs on PGL in performing operational work on its infrastructure located under the City's Public Ways that it will not recover in current rates. JA Init. Br. at 45. This point is unpersuasive for several reasons, according to City-CUB. City-CUB demonstrate that the fees, fines, and penalties PGL incurs are largely within PGL's control. If PGL improved its AMRP construction management to achieve better coordination with the City of Chicagoto take advantage of savings opportunities in the new CDOT regulations, and to better monitor and control its budgets, schedules, and quality of work, as City-CUB recommend, its additional costs would be minimized. City-CUB showed that just as a five-year freeze could incent the Companies to maximize reorganization savings (City/CUB Ex. 8.0 at 4:78-80), so could it provide an incentive to PGL to reduce its construction costs through more effective and efficient management of its AMRP program.

City/CUB reiterate the point that the Joint Applicants have ignored the savings opportunities included in new CDOT regulations. City/CUB Init. Br. at 62; City/CUB Ex. 8.0 at

4:81-83. City-CUB say that the Joint Applicants have failed to quantify, or even acknowledge, the management efficiencies provided for in the CDOT regulations and through the PCO process. City/CUB Ex. 3.0 at 421-425. If properly managed and communicated, claim City-CUB, PGL could complete AMRP and other construction work as scheduled and budgeted, which should result in reduced costs for PGL's ratepayers, as well as for the City's taxpayers. Such prudent management also could avoid having to ask that Chicago ratepayers pay even higher rates. City-CUB Ex. 3.0 at 589-603. Since the Joint Applicants have not defined protocols to identify and track transition costs/savings and propose to address them only in a rate case, City-CUB showed that savings achieved by PGL and NS during a freeze would likely accrue to the utilities' shareholders. If that approach is allowed, the onus should be on those companies to maximize savings, and a longer rate freeze creates greater incentives for the companies to do so.

The Joint Applicants' oppose Mr. Gorman's proposed rate freeze extension by claiming that such a measure is unnecessary. The Joint Applicants "expect that there will be net savings, over time, as they integrate their management, systems and operations, and these savings will be reflected in future rate proceedings for the benefit of Illinois customers by way of reduced operating expenses or lower capital costs." JA Init. Br. at 45, *citing* JA Ex. 17.0, 5:83-87. However, City-CUB argue that the Joint Applicants have declined to do transition planning to capture available savings, delayed their transition (precluding near-term savings), and neglected development of protocols to identify, quantify and to track transition costs and savings that could be produced by the reorganization. Thus, aver City-CUB, adverse rate impacts could result from the Joint Applicants' disincentive to achieve and account for cost-saving synergies prior the time the rate freeze ends.

City-CUB further maintain that the Joint Applicant's proposed problematic treatment of transition costs and a short freeze period would encourage the Joint Applicants to put off integration plans that could benefit customers until the freeze period ends. At the end of the freeze, cost recovery risks associated with expenditures for integration planning and execution (to achieve reorganization savings) are transferred from shareholders to ratepayers through the proposed scheme for transition cost recovery in rate cases. City-CUB aver that ratepayers would pay for implementing the management/shareholder reorganization decision, and shareholders would be insulated from the possibility of large losses from failed synergy expectations or a poor reorganization gambit. Tellingly, say City-CUB, under the Joint Applicants' proposed time lines, the transition is projected to begin, costs are expected to be incurred, and transition costs will be eligible for rate recovery at about the same time that the proposed freeze would end. *See* JA Ex. 9.0 (Schott) at 25:534.

City/CUB urge the Commission to extend the Joint Applicants' commitment to freeze rates from two years to five years, in order to assure rate stability and to prevent adverse rate impacts over the period of the freeze.

IV. CONCLUSION

City/CUB oppose approval of the proposed reorganization and recommend that the Commission reject the application. The answers to Section 7-204's fundamental "Yes/No" questions -- whether the proposed reorganization is authorized and appropriate for approval -- are "no" in each instance. On the whole, the record in this case leaves no doubt that approval is not easily supported, and (even with additional conditions) may ultimately be unsustainable.

If despite the evidence of record the Commission approves the proposed reorganization, it must be heavily and firmly conditioned, with measurable and enforceable compliance. City/CUB have nonetheless presented a minimum slate of conditions that must be attached to any approval order. The Joint Applicants' tactic of minimal evidentiary presentations has left the Commission with the difficult tasks of identifying specific needs for additional terms and conditions and defining those conditions so that they are meaningful, effective, and enforceable.

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Respectfully submitted,

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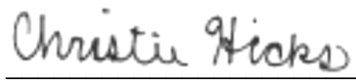

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